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### Economic Insights

# Is Canada Losing Its Status as a Debtor Nation?

*by Ryan Macdonald and Guy Gellatly*

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|                |  |
|----------------|--|
| .              | not available for any reference period   |
| ..             | not available for a specific reference period  |
| ...            | not applicable   |
| 0              | true zero or a value rounded to zero   |
| 0 <sup>s</sup> | value rounded to 0 (zero) where there is a meaningful distinction between true zero and the value that was rounded |
| <sup>p</sup>   | preliminary  |
| <sup>r</sup>   | revised  |
| X              | suppressed to meet the confidentiality requirements of the <i>Statistics Act</i>                                   |
| E              | use with caution   |
| F              | too unreliable to be published   |
| *              | significantly different from reference category ( $p < 0.05$ )   |

# Is Canada Losing Its Status as a Debtor Nation?

By Ryan Macdonald and Guy Gellatly

This article in the *Economic Insights* series reports on long-run changes in the value of Canada's external financial assets and liabilities. It summarizes results from the research paper, *Canada's International Investment Position: Recent Trends and Implications for Aggregate Measures of Income and Wealth*, and is part of an ongoing research program at Statistics Canada that investigates the international dimensions of the Canadian economy.

Foreign investments in Canada often garner headlines and spark debates over whether injections of foreign debt and equity into Canadian companies will have positive impacts on the ability of Canadian industries to grow, create jobs, and develop innovative products. Such debates have an enduring place in the nation's economic history, reflecting the fact that, from the earliest days, foreign capital has been an important source of funds for Canada's industries. The extent to which Canadian businesses, households and governments also invest in foreign economies is less recognized, and the overall value of these investments has increased in recent decades. This, in turn, has had a pronounced impact on Canada's net financial position in relation to the rest of the world.

## Assets rising relative to liabilities

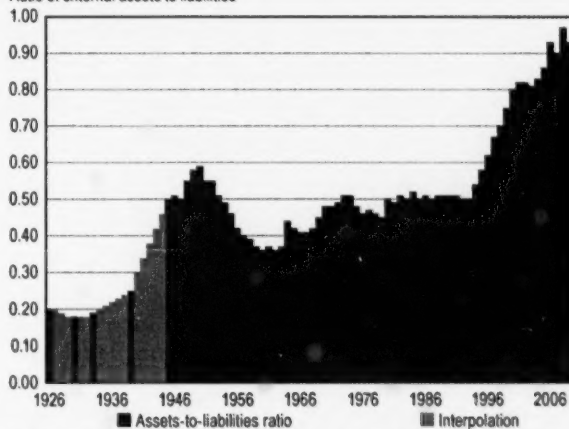
Information about foreign investments in Canada and Canadian investments abroad is collected and compiled by Statistics Canada to estimate the value of assets that foreigners hold in Canada (Canada's financial liabilities) and the value of assets that Canadians hold abroad (Canada's financial assets). The difference between the value of these assets and liabilities is Canada's net international investment position (net IIP). It can be tracked through time by examining changes in its dollar value or in the ratio of the value of external financial assets to the value of external financial liabilities. If the ratio is less than 1.0, the value of Canada's foreign assets is less than the value of Canadian assets held by foreigners.

Over roughly four generations, Canada's financial position vis-à-vis the rest of the world improved markedly. In 1926, the value of external assets that Canada had accumulated was 20% of the value of its external liabilities; by 2010, the figure had risen to 88% (Chart 1). This growth of Canada's external assets relative to its external liabilities raises questions about why the increase occurred, and why it accelerated after the early 1990s.

Chart 1

Canada's international assets relative to liabilities, 1926 to 2010

Ratio of external assets to liabilities



Note: Data on net international investment position stocks are collected annually after 1945. Prior to that, estimates exist for particular years. Chart 1 is constructed using a linear interpolation between existing data points where historical estimates do not exist.

Source: Statistics Canada, CANSIM table 376-0037.

**Table 1**  
**Compound annual growth rates of assets and liabilities, by decade, 1951 to 2010**

|                          | 1951 to 2010 | 1951 to 1960 | 1961 to 1970 | 1971 to 1980 | 1981 to 1990 | 1991 to 2000 | 2001 to 2010 | 2009 to 2010 |
|--------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
|                          | percent      |              |              |              |              |              |              |              |
| <b>Total assets</b>      | <b>9.8</b>   | <b>4.7</b>   | <b>12.3</b>  | <b>15.5</b>  | <b>8.1</b>   | <b>12.7</b>  | <b>5.4</b>   | <b>0.9</b>   |
| Direct investment        | 11.1         | 8.7          | 10.1         | 17.1         | 11.9         | 14.1         | 4.9          | -0.7         |
| Portfolio investment     | 11.6         | 8.9          | 7.7          | 13.6         | 16.8         | 17.1         | 5.7          | -1.6         |
| Bonds                    | 12.2         | 7.2          | 6.2          | 6.7          | 29.8         | 13.6         | 14.2         | -4.6         |
| Shares <sup>1</sup>      | 11.4         | 9.4          | 8.1          | 14.7         | 14.3         | 17.9         | 3.1          | -0.1         |
| Other investment         | 8.3          | 2.4          | 14.2         | 15.2         | 4.4          | 8.8          | 5.6          | 5.6          |
| <b>Total liabilities</b> | <b>8.9</b>   | <b>9.6</b>   | <b>8.9</b>   | <b>15.1</b>  | <b>7.6</b>   | <b>7.3</b>   | <b>4.5</b>   | <b>6.3</b>   |
| Direct investment        | 8.5          | 12.7         | 7.4          | 9.3          | 7.1          | 10.0         | 5.7          | 2.6          |
| Portfolio investment     | 8.9          | 6.0          | 7.7          | 17.6         | 11.9         | 7.1          | 3.7          | 13.9         |
| Bonds                    | 9.3          | 5.2          | 9.8          | 18.8         | 12.1         | 6.3          | 3.4          | 15.5         |
| Shares <sup>1</sup>      | 7.8          | 7.3          | 4.3          | 14.4         | 11.2         | 10.2         | 5.2          | 8.4          |
| Other investment         | 9.9          | 9.5          | 15.2         | 19.7         | 3.4          | 4.8          | 4.3          | -1.1         |

1. Includes money market assets/liabilities.

Source: Authors' calculations, Statistics Canada.

### Improving position due to Canadians investing abroad

Improvements in Canada's net IIP are the result of Canadians investing more abroad, not foreigners investing less in Canada. The pace at which Canadians invested abroad increased relative to the growth of foreign investment in Canada (Table 1). Between 1951 and 2010, the value of foreign assets owned by Canadians increased, on average, by 9.8% per year, compared with an 8.9% increase in the value of foreign assets in Canada.

The increase in Canadian investments abroad was not constant through time, nor was it consistent across investment categories. The 1960s and 1970s saw larger gains in direct investments and in the category "other investment," which includes short-term receivables and payables and banking assets and liabilities. During these years, foreign investments in Canada trailed behind Canadian investments abroad.

The 1980s saw a rise of Canadian portfolio investments abroad, as investments in foreign bonds and stocks increased rapidly from a relatively low initial level. Foreign investments in Canada, particularly portfolio investments, continued to expand during these years.

During the 1990s, Canada's stock of foreign portfolio assets continued to increase (an average of 17.1% per year), while the stock of foreign portfolio assets in Canada grew more slowly than in previous decades. Consequently, the overall value of Canada's external financial assets grew more rapidly than did the value of its external liabilities, improving Canada's net international investment position.

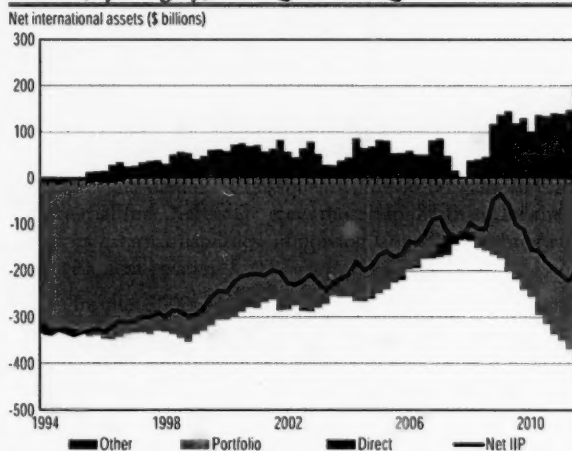
In the 2000s, Canada's external asset growth continued to outpace increases in external liabilities. Once again, the largest difference between Canadian and foreign activity was in portfolio investment. This pattern held until mid-2007, after which Canadian portfolio investors pulled back while foreign portfolio investments increased substantially. Consequently, by 2009, for the first time in two decades, the growth of overall foreign investment in Canada surpassed the growth of overall Canadian investment abroad.

### Structural changes after 1990

Canada's net IIP increased most rapidly in the 1940s and the 1990s. During the Second World War, loans to allies bolstered Canada's assets. During the 1990s, a variety of structural factors converged to facilitate investment abroad.

The 1990s witnessed the collapse of the Soviet Union, the advent of the North American Free Trade Agreement, greater global financial integration, China's emergence as an economic power, and the growth of developing market economies. In Canada, content restrictions on foreign investments were partially removed from pensions. Accordingly, the scope of markets in which Canadians could invest broadened, and the pool of savings that could be invested internationally increased. Canada's net holdings of external portfolio assets increased substantially (Chart 2).

**Chart 2**  
**Net IIP, by category, 1994 Q1 to 2011 Q3**



Notes: Net IIP: net international investment position; Q: quarter.  
 Source: Statistics Canada, CANSIM table 376-0037.



### Portfolio investments leading a reversal

Greater portfolio investment abroad is also the main reason that Canada's net IIP declined through most of the 1990s and 2000s, and why it increased after 2008. The net inflow of foreign portfolio investment reversed course after 2007, and became sufficiently large in 2009 that it widened the gap between Canada's external assets and liabilities. Net IIP in the third quarter (Q3) of 2011 was \$189.5 billion, roughly the same as in 2004. However, because the domestic economy expanded between 1994 and 2011, the external debt stood at 11% of gross national income<sup>1</sup> in 2011 Q3, down from 46% in 1994 Q1, and from the 14% to 17% recorded in 2004 when the level of net IIP was similar to the current level.

### Towards becoming an international creditor

In recent decades, Canadians increased their holdings of foreign assets more rapidly than foreigners acquired Canadian assets. The result was a narrowing of the difference between the stock of Canada's foreign assets and the stock of Canada's foreign liabilities. While the gap widened after the global financial crisis and recession of 2007 to 2009<sup>2</sup>, the record shows that Canada's net external debt has declined significantly over the last century.

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1. 'Gross national income' is the income aggregate formerly known as 'gross national product.'

2. See Boulay (2010).

## References

This *Economic Insights* article is based on:

Boulay, E. 2010. "The evolution of the global financial crisis and cross-border financial activity, 2007-2010." *Canadian Economic Observer*. Vol. 23. No. 9. Statistics Canada Catalogue no. 11-010-X.

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